

Internal Revenue Service

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LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter is in response to your request, dated December 23, 2008, on behalf of X, seeking inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

Based on the materials submitted and representations within, we understand the relevant facts to be as follows. X was incorporated in State on Date 1. X made an election to be treated as an S corporation effective Date 2. On Date 3, X amended its articles of incorporation to include both for the designation of Voting Shares and Nonvoting Shares ("Date 3 Amended Articles"). Article 2.2 of the Date 3 Amended

Articles provides that the common stock shall be identical in all respects, except for certain voting rights. Article 2.4(a) provides for an automatic conversion of Nonvoting Shares into Voting Shares immediately prior to the closing of a "Liquidity Event," a defined term within the Date 3 Amended Articles.

On Date 4, X's shareholders exchanged some of their Voting Shares for Nonvoting Shares. Following the exchange, the shareholders of X were advised by their legal counsel and accountants that Article 2.4 of the Date 3 Amended Articles could possibly be interpreted to provide differing rights to Voting Shares and Nonvoting Shares upon the occurrence of certain hypothetical events. An affidavit from the drafting attorney included with the ruling request indicates that Article 2.4 was included in the Date 3 Amended Articles to ensure that the Voting Shares and Nonvoting Shares will be identical in all respects in the case of a Liquidity Event.

On Date 5, in order to eliminate any potential inconsistencies between Article 2.2 and Article 2.4, X filed amendments to the Date 3 Amended Articles with the Secretary of State.

X and its shareholders represent that all allocations of income, losses, deductions and credits for X were made on a pro rata basis among all the shareholders of both classes of stock as though all shares were one class of stock for all years at issue. In addition, no disproportionate distributions were made for any years at issue.

In accordance with § 1362(f) and § 1.1362-4, X and each person who has been a shareholder of X at any time after Date 4 through the date of the ruling request have consented to any adjustments as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law,

and binding agreements relating to distribution and liquidation proceeds (collectively, the "governing provisions"). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1.1361-1(l)(2)(iii)(B) provides that bona fide agreements to redeem or purchase stock at the time of death, divorce, disability, or termination of employment are disregarded in determining whether a corporation's shares of stock confer identical rights.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the information submitted and the representations made, we conclude that X's S corporation election may have terminated because X may have had more than one

class of stock. However, we conclude that, if X's S election was terminated, such a termination was inadvertent within the meaning of § 1362(f) of the Code.

Further, we conclude that the corrective action taken by X and its shareholders does not create a second class of stock under § 1361. Consequently, we rule that X will be treated as continuing to be an S corporation from Date 2, and thereafter, provided that X's S election otherwise is not terminated under § 1362(d).

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the code. In particular, no opinion is expressed or implied as to whether X otherwise qualifies as a subchapter S corporations under § 1361.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and are accompanied by a perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to the taxpayer representatives.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1)

Copy of Letter for § 6110 purposes